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## What Happened to the 'Depression'?

*Despite the rhetoric from Washington, we were never close to 25% unemployment.*

By ALLAN H. MELTZER

Day after day, economists, politicians and journalists repeat the trope that the current recession is the worst since the Great Depression. Repetition may reinforce belief, but the comparison is greatly overstated and highly misleading. Anyone who knows even a bit about the Great Depression knows that this is false.

The facts we face today are very different than the grim reality Americans confronted between 1929 and 1932. True, this recession is not over. But it would have to get improbably worse before it came close to the 42-month duration of the Great Depression, or the 25% unemployment rate in 1932. Then, the only safety net was the soup line.

The current recession is also much less severe than the 1937-38 Depression. A more accurate comparison is to the 1973-75 recession. Today's recession is as deep and most likely won't be much longer than the one we experienced some three decades ago. By pointing this out, I do not intend to minimize the damage that the economic crisis has had on individuals and businesses. But as policy makers make decisions in order to alleviate the recession, they are not helped when economists overstate its severity.

### How the Recession Compares

	Duration (months)	Decline in Real GDP	Decline in Industrial Production	Increase Unemployment Rate	Max Rate
2007-June 2009	18	3.8%	15.9%	4.6%	9.5%
1937-38	13	18.2	32.4	9.0	20.0
1973-75	16	4.9	15.3	4.4	9.0
1981-82	16	3.0	12.3	3.6	10.8

Source: Allan H. Meltzer

The table nearby compares the current recession, the 1937-38 depression and some past severe postwar recessions. If the recession ends this summer—as many experts predict—the record will show that it was not very different from other postwar recessions, but very different from the 1937-38 and 1929-32 Depressions.

So why do many opinion makers insist on inaccurate and frightening analogies that overstate the severity of present conditions? I believe there are several reasons.

First, there is a strong political motivation to make this recession out to be worse than it actually is. The Obama administration wanted to make it appear as though it saved us from an incipient disaster, so it overstated its achievements. The White House also wanted to foist its huge "stimulus" program on the country in order to redistribute income. That pleased many Democrats, but did very little to restore growth.

Many others repeated the administration's hyperbolic

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claims. One reason is because there is genuine uncertainty about what has happened and what is likely to come. Short-term forecasts have major errors, and extrapolation of current data adds to misinformation. Then there are economists who would like to see government take a larger role in the economy. They've chosen to use the recession as a pretext for arguing for this change.

New York Times columnist Paul Krugman and the International Monetary Fund repeatedly proclaimed that more government spending was a necessity. Most economists now believe that the recession is expected to end before much of the government spending takes hold. And while the improvement in recent GDP data reflects a big increase in government spending, consumer spending declined again in the second quarter. The \$787 billion of fiscal stimulus has done little for consumers. Keynesian economists always fail to recognize the powerful regenerative forces of the market economy. The financial press—many of whom share their same political assumptions—endlessly reproduces their beliefs.



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The Federal Reserve also shared this Keynesian viewpoint. It provided unprecedented monetary stimulus, increasing the monetary base by more than \$1 trillion. Much of this increase corrected for its major mistake: allowing Lehman Brothers to fail. After 30 years of bailing out almost all large financial firms, the Fed made the horrendous mistake of changing its policy in the midst of a recession. That set off a scramble for liquidity and heightened the public's distrust in the market.

This had world-wide repercussions. For four months, many financial markets remained frozen and real activity

collapsed. Allowing Lehman to fail without warning is one of the worst blunders in Federal Reserve history. Extrapolation caused many market participants to conjecture that we were in a depression. The New York Times and others piled on, speculating foolishly about the end of capitalism.

Now, with recovery in sight, we need to ask what kind of a recovery to expect and what kind of policies are appropriate. My best guess is that the recovery will be a bumpy ride along a low-growth path. Recovery will be helped by lots of monetary stimulus and low inventories. Some calendar quarters will see healthy growth, but trend growth will be low because housing will remain weak, the cash for clunkers program borrowed sales from the future, and the Obama administration's economic program raises business costs and reduces profits.

Many pundits argue that we need another stimulus package. I disagree. The proper response now is to repeal what remains of the misguided stimulus and avoid the cap-and-trade program.

In their response to the recession, Congress and the administration were more interested in redistributing income than encouraging growth. They also ignored the lessons of the successful Kennedy and Reagan reductions in marginal tax rates. They added to their mistakes by enacting a temporary tax reduction as a main element of the \$787 billion stimulus. Don't they know that Presidents Ford, Carter and Bush failed to stimulate spending with temporary tax reductions?

A sensible administration would revise its policy. It should start by scrapping what remains of the stimulus. As the world economy recovers, the United States should choose to expand its exports so that it can service its large and growing foreign debts. That means reducing corporate tax rates to increase investment. Instead of implementing policies that increase regulation and raise business costs, we need to increase productivity. And the Fed should soon begin to reduce the massive volume of outstanding bank reserves, which is the raw material for future money growth.

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